

Draft Decision

Essential Energy

Electricity Distribution

Determination 2024 to 2029

(1 July 2024 to 30 June 2029)

Attachment 11

Demand management incentive
scheme and Demand management
innovation allowance mechanism

September 2023

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11 Demand management incentive scheme and Demand management innovation allowance

Under clauses 6.6.3 and 6.6.3A of the National Electricity Rules (NER), our regulatory determination must specify how any applicable demand management incentive scheme (DMIS)¹ and demand management innovation allowance mechanism (DMIAM)² are to apply in the next regulatory control period.

This attachment sets out how we will apply the DMIS and DMIAM to Essential Energy for the 2024–29 period.

11.1 Draft decision

11.1.1 Demand management incentive scheme

In accordance with our framework and approach (F&A),³ our draft decision is to apply the DMIS⁴ to Essential Energy for the 2024–29 period.

The DMIS contains three elements:⁵

- An incentive payment in the form of uplift to the actual cost (the cost multiplier) of up to 50% of expected costs of efficient demand management projects.
- A net benefit constraint, to ensure the incentive payment for any project cannot be higher than that project's expected net benefit.
- An overall incentive constraint, which limits the total incentive in any year to 1% of the distributor's annual revenue requirement for that year.

The DMIS is also subject to an annual review and approval process through our prescribed DMIS compliance reporting requirements. In accordance with the DMIS, our distribution determination will provide that the cost multiplier applicable to any eligible project will be the cost multiplier specified in the current version of the DMIS that is in effect at the time the eligible project becomes a committed project.⁶

¹ AER, *Demand management incentive scheme, Electricity distribution network service providers*, December 2017.

² AER, *Demand management innovation allowance mechanism, Electricity distribution network service providers*, December 2017.

³ AER, *Final framework and approach for Ausgrid, Endeavour Energy and Essential Energy for the 2024–29 regulatory control period*, July 2022.

⁴ AER, *Demand management incentive scheme, Electricity distribution network service providers*, December 2017.

⁵ AER, *Demand management incentive scheme, Electricity distribution network service providers*, December 2017.

⁶ AER, *Demand management incentive scheme, Electricity distribution network service providers*, December 2017, cl 2.1(2).

11.1.2 Demand management innovation allowance mechanism

In accordance with our F&A⁷ our draft decision is to apply the DMIAM⁸ to Essential Energy for the 2024–29 period.

The DMIAM comprises:⁹

- a fixed allowance of \$0.2 million (\$2017), plus 0.075% of the annual revenue requirement for each regulatory year, as set out in our Post-Tax Revenue Model (PTRM) for Essential Energy
- project eligibility requirements
- compliance reporting requirements.

In our final distribution determination, we will determine the amount of the DMIAM allowance for Essential Energy for the 2024–29 period, based on the final PTRM for Essential Energy.

11.2 Essential Energy’s proposal

11.2.1 Demand management incentive scheme

Essential Energy proposed to continue to apply the DMIS for the 2024–29 period.¹⁰

11.2.2 Demand management innovation allowance mechanism

Essential Energy proposed to continue to apply the DMIAM for the 2024–29 period.¹¹

Essential Energy proposed a DMIAM allowance of \$5.6 million (\$2023–24) for the 2024–29 period.¹²

11.3 Assessment approach

Under the NER, we are required to decide how the DMIS and DMIAM will apply to Essential Energy.¹³ We outlined our proposed approach, and the reasons for our proposed approach, in our F&A.¹⁴ Our draft decision has adopted the position in our F&A. We have considered materials submitted to us by Essential Energy.

⁷ AER, *Final framework and approach for Ausgrid, Endeavour Energy and Essential Energy for the 2024–29 regulatory control period*, July 2022.

⁸ AER, *Demand management innovation allowance mechanism, Electricity distribution network service providers*, December 2017.

⁹ AER, *Demand management innovation allowance mechanism, Electricity distribution network service providers*, December 2017.

¹⁰ Essential Energy, *Regulatory proposal 2024–2029*, January 2023, pp. 60.

¹¹ Essential Energy, *Regulatory proposal 2024–2029*, January 2023, pp. 60.

¹² Essential Energy, *Regulatory proposal 2024–2029, Attachment 5.04 Standard Control Post Tax Revenue Model*, January 2023.

¹³ NER, cl. 6.3.2(a)(3) and 6.12.1(9).

¹⁴ AER, *Final framework and approach for Ausgrid, Endeavour Energy and Essential Energy for the 2024–29 regulatory control period*, July 2022.

11.3.1 Interrelationships

The DMIS encourages distribution businesses to find lower cost solutions to investing in network solutions. The incentive scheme achieves this by providing distribution businesses with financial incentives to undertake efficient expenditure on non-network solutions to manage peak electricity demand.

In applying the DMIS, we consider the effect it has on the incentives created by our other incentive schemes – the efficiency benefit sharing scheme (EBSS), the capital expenditure sharing scheme (CESS), and the service target performance incentive scheme (STPIS) – and vice versa.

The CESS and the EBSS are incentive schemes designed to encourage efficient decision making by distribution network service providers (DNSPs). These schemes operate symmetrically to better balance incentives between capital expenditure (capex) and operating expenditure (opex), by sharing the savings and risks of each kind of expenditure between DNSPs and consumers.

As explained in our final decision for the DMIS,¹⁵ we consider that the symmetrical operation of incentives under the CESS and EBSS should balance out any negative impacts that DNSPs may experience under any of these schemes. For instance, as DNSPs spend more on opex, they may exceed their targets under the EBSS and receive a smaller incentive or higher penalty as a result. However, since the DMIS only incentivises efficient demand management projects, we would expect that reductions in capex gained from project deferral or avoidance would exceed any increase in opex under the demand management project. In this scenario, benefits under the CESS would outweigh any detriment under the EBSS.¹⁶ Hence, we expect the DMIS will encourage DNSPs to undertake more demand management activities where it is efficient to do so.

We will not exempt supply outage due to malfunction of DMIS projects from the STPIS. This is because we consider this would negatively affect consumers in two ways. First, exempting demand management solutions from the STPIS would transfer the risk of failure to consumers, who have little opportunity to mitigate that risk. Second, exempting demand management from performance targets may increase the perception that demand management is less reliable than network solutions, furthering any potential cultural bias against demand management. This would not serve to support the objective of the DMIS, which is to promote efficient investment in non-network options, or standalone power system (SAPS), relating to demand management.¹⁷

The DMIAM is not an incentive scheme. Its objective is to provide distribution businesses with funding for R&D in demand management projects that have the potential to reduce long-term network costs. This allowance will fund innovative projects that have the potential to deliver ongoing reductions in demand or peak demand. The DMIAM will complement the

¹⁵ AER, *Explanatory statement, demand management incentive scheme, Electricity distribution network service providers*, December 2017.

¹⁶ AER, *Explanatory statement, demand management incentive scheme, Electricity distribution network service providers*, December 2017, p. 60.

¹⁷ NER, cl. 6.6.3(b).

DMIS and increase the capacity of distribution business to invest in ideas that may eventually become DMIS projects to reduce future capex and opex costs.

11.3.2 Submissions

We received no submissions from stakeholders on our demand management incentive schemes.

11.3.3 Engagement with the DMIAM

DNSPs have different approaches for utilising DMIAM funding. Table 11.1 shows DMIAM expenditure (2019–22) as a share of total allowance for NSW, ACT, TAS and NT distributors. Overall, by the third year (2021–22) of the 5-year regulatory period, the six distributors have spent an average of 33% of their DMIAM allowances. Essential Energy is below this average. We encourage Essential Energy to continue its demand management innovation activity to assist the industry in developing new ways to reduce long-term network costs.

Table 11.1 DMIAM expenditure compared to allowance for the 2019–24 period (\$000, \$2021–22)

| Distributor | 2019–20 | 2020–21 | 2021–22 | Total expenditure (3 years) | Allowance (5 years) | Expenditure / Allowance |
|--------------------|---------|---------|---------|-----------------------------|---------------------|-------------------------|
| Essential Energy | 14 | - | 251 | 265 | 4,883 | 5.4% |
| Total ^a | 1,965 | 2,250 | 2,895 | 7,110 | 21,787 | 32.6% |

Note (a) Total includes all distribution businesses with a 2019–24 regulatory control period, that is, Ausgrid, Endeavour Energy, Essential Energy, Evoenergy, TasNetworks (distribution business only) and Power and Water Corporation.

11.4 Reasons for draft decision

Distribution businesses can manage demand on their networks to reduce, delay or even avoid the need to install, replace or upgrade expensive network assets. Network assets include equipment like poles, wires, transformers and substations. When used effectively, managing demand to avoid incurring these costs can reduce upward pressure on network charges, which make up about half the cost of electricity bills.

Managing demand on electricity networks can increase the reliability of supply and reduce the cost of supplying electricity. Often, electricity consumers are empowered to manage demand via price signals and enabling technology.

Price signals or financial incentives can reward consumers for using electricity in a way that allows network businesses to keep their costs down. These signals or incentives may come in the form of things like cost-reflective tariffs, congestion pricing, and rebates. Enabling technology often complements price signals by empowering consumers' use of electricity in a way that allows network businesses to keep their costs down. This technology may include things like advanced metering technology, demand response enabling devices, and energy monitoring apps.

11.4.1 Demand management incentive scheme

We propose to apply this scheme because it will deliver long term benefit to consumers. DNSPs can only receive DMIS incentive payments for demand management projects that are efficient and contribute, partially or wholly, to resolving a network constraint. In deciding

whether a project is efficient, we require distribution businesses to test the demand management services market, which should increase transparency, promote competition, and put greater downward pressure on electricity prices, benefitting the whole community.

Regarding the control of and to ensure the effective implementation of the scheme, we require that Essential Energy provide compliance reports and supporting documents each year as required under the DMIS—to prove that its eligible and committed projects and expenditures meet the requirements of the scheme. We will determine the eligibility and specific incentive payments for each project according to the requirements of the DMIS.

11.4.2 Demand management innovation allowance mechanism

The DMIAM provides funding to DNSPs:

- to undertake research and development on demand management initiatives that have the potential to reduce long term network costs; and
- to share these learnings across industry and consumers through the public reporting requirement of the scheme.

Effective use of this allowance can lead to development of good programs for reducing network costs. We consider that this allowance should be included in the next regulatory control period.

Any unused funding under the DMIAM will be returned to consumers in the ensuing 2029–34 period.

Essential Energy is required to provide to the AER DMIAM compliance reports and supporting documents each year to prove that its research and development projects and expenditures meet the requirements of the mechanism. We will determine the eligibility and DMIAM payments for each project according to the criteria specified in the DMIAM.¹⁸

¹⁸ AER, *Demand Management Innovation Allowance Mechanism*, 14 December 2017.

Shortened forms

| Term | Definition |
|-------|--|
| AER | Australian Energy Regulator |
| capex | capital expenditure |
| CESS | capital expenditure sharing scheme |
| DMIAM | demand management innovation allowance mechanism |
| DMIS | demand management incentive scheme |
| DNSP | distribution network service provider |
| EBSS | efficiency benefit sharing scheme |
| F&A | framework and approach |
| NEM | National Electricity Market |
| NER | National Electricity Rules |
| opex | operating expenditure |
| PTRM | post-tax revenue model |
| R&D | research and development |
| SAPS | standalone power systems |
| STPIS | service target performance incentive scheme |
